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ACTION EUR-12

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TO SECSTATE WASHDC 5975
INFO AMEMBASSY BONN
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TAGS: OECD, ECON
SUBJECT: ECONOMIC POLICY COMMITTEE/WORKING PARTY 4,
JUNE 29-30, 1978

REF: (A) CPE/WP4(78)1, 2, 3, 4; DES/NI(78)12;
(B) PARIS 21456

1. SUMMARY AND INTRODUCTION: AT JUNE 29-30 MEETING,
EPC/WP-4 BEGAN LONG-RANGE PROJECT DEVOTED TO ANALYSIS
OF UNDERLYING FACTORS WHICH CONTRIBUTE TO PRESENT PER-
SISTENT INFLATION IN OECD ECONOMIES. SECRETARIAT PRE-
SENTED FOUR PRELIMINARY PAPERS (ON WAGE STRUCTURE, ON
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REAL WAGES AND TERMS OF TRADE, ON NON-WAGE AND "FIXED"
LABOR COSTS, AND ON MONETARY TARGETRY) WHICH EVOKED
HIGHLY TECHNICAL DISCUSSION (AT LEAST ON FIRST THREE
LISTED) WITHIN WP, WITH PARTICULARLY IMPORTANT CONTRI-
BUTIONS FROM U.S., BELGIUM, CANADA, ITALY, AND UK. U.S.
DEL WAS HEADED BY GRAMLEY (MEMBER, CEA), AND INCLUDED
WYSS (CEA), TRUMAN (FRB) AND JONIEZ (STATE). WP WEL-

COMED SHIFT OF EMPHASIS FROM TRADITIONAL "TOUR DE TABLE" ON WAGE, COST AND PRICE CONDITIONS TO MORE ANALYTICAL APPROACH TO CAUSES OF INFLATION. U.S. AND OTHER DELS NOTED IN THIS CONTEXT THAT ANALYTICAL DOCUMENTATION IS LESS TIME-SENSITIVE THUS COULD, AND GIVEN ITS MORE TECHNICAL NATURE MUST, BE CIRCULATED FARTHER IN ADVANCE OF MEETING, PREFERABLY AT LEAST ONE MONTH. WP AGREED THAT PRELIMINARY PAPERS PREPARED FOR JUNE MEETING SHOULD BE EXPANDED AND CONSOLIDATED TO HIGHLIGHT THEIR POLICY IMPLICATIONS FOR CONSIDERATION AT FALL MEETING. SEVERAL DELS AND SECRETARIAT SUGGESTED THAT EFFECTIVE PRICE AND INCOMES POLICIES WERE POSSIBLE SOLUTION TO SOME OF THE PROBLEMS RAISED IN COURSE OF PRELIMINARY DISCUSSION; WP AGREED TO UNDERTAKE ASSESSMENT OF INCOMES POLICIES IN FALL. WP SCHEDULED FALL MEETING FOR NOVEMBER 30/DECEMBER 1. END SUMMARY AND INTRODUCTION

2. PRELIMINARY REPORT ON WAGE DIFFERENTIALS
(CPE/WP4(78)3: SECRETARIAT ANALYSIS OF WAGE STRUCTURE INITIALLY ASSUMED THAT SECTORAL WAGE DETERMINATION WOULD BE MICRO ECONOMIC PHENOMENON, BUT ATTEMPTS TO VERIFY THIS HYPOTHESIS RESULTED IN ITS REJECTION IN FAVOR OF MACRO DETERMINATION. SEVERAL WP-4 DELS (INCLUDING U.S.) SUGGESTED THAT MACRO HYPOTHESIS DID NOT HOLD EITHER AS WAGES DID NOT SEEM IN MANY CASES TO BE RESPONSIVE TO CYCLICAL ACTIVITY OF THE ECONOMY. THERE WAS CONSIDERABLE SUPPORT LIMITED OFFICIAL USE

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FOR "KEY SECTOR" MODELS IN WHICH SPECIFIC INDUSTRY (WHETHER DUE TO TIMING OF SETTLEMENT (UK, FRG) OR DEGREE OF UNIONIZATION (U.S.) OR REGION (ITALY)) SET THE PACE FOR ENTIRE WAGE ROUND. FEELING WIDESPREAD THAT "KEY SECTOR" MODEL (PARTICULARLY IN UK) MAY INVOLVE MICRO INFLUENCES IN "KEY SECTOR" BARGAINING, BUT OVERALL WAGE ROUND NOT MICRO PHENOMENON. CONSIDERABLE DOUBT WAS EXPRESSED OVER THE EFFECTIVENESS OF DEMAND MANAGEMENT TO HOLD DOWN WAGE SETTLEMENT -- U.S. DEL IN PARTICULAR ARGUED THAT SLACK LABOR MARKET HURT LOWER PAID, NON-UNION (I.E., "COMPETITIVE") SECTOR HARDEST WHILE UNIONIZED SECTOR SETTLEMENTS WERE VIRTUALLY UNAFFECTED. FRG DEL FELT UNIONS ACT QUICKLY TO TAKE ADVANTAGE OF ECONOMIC STRENGTH (SECTORAL OR OVERALL) TO DEMAND WAGE INCREASES, WHILE THEY RESIST WAGE SLOWDOWN IN PERIODS OF WEAKNESS. WP-4 CHAIRMAN (SLATER, CANADA) SUMMARIZED DISCUSSION AS FOLLOWS: (A) THERE DOES NOT SEEM TO BE A GENERAL MODEL OF WAGE DETERMINATION WHICH WILL FIT ALL OECD COUNTRIES -- GIVEN INSTITUTIONAL DIVERSITY -- BUT SOME COMMON THREADS EXIST; (B) ON BALANCE, MACRO AND SOCIO-INSTITUTIONAL FACTORS HAVE OUTWEIGHED MICRO FACTORS IN THE RECENT

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PERIOD, BUT THERE IS NO SIMPLE CROSS-COUNTRY EXPLANATION
OF WAGE DIFFERENTIALS; (C) SOME PATTERNS OF WAGE SETTLE-
MENT MAKE NO SENSE IN EITHER MICRO OR MACRO ECONOMIC
TERMS, BUT AN EXPLANATION MUST EXIST; (D) WAGE AND PRO-
DUCTIVITY BEHAVIOR (ESPECIALLY WHEN DIFFERENT) POSE
ECONOMIC PROBLEMS WHICH BEAR ON INFLATION, GROWTH AND
UNEMPLOYMENT; (E) THERE IS STRONG BELIEF IN WP THAT
UNIONS WILL NOT ACCEPT DOWNWARD FLEXIBILITY OF REAL
WAGES; AND (F) THERE IS NEED FURTHER TO ANALYZE IMPLI-
CATIONS FOR INFLATION OF NEW WAGE DETERMINATION PROCESS.

3. PRELIMINARY REPORT ON REAL WAGE ADJUSTMENTS
(CPE/WP4(78)4): WP ROUNDLY APPLAUDED THIS PAPER AS A
USEFUL CONTRIBUTION TO UNDERSTANDING IMPACT ON, AND
TRANSMISSION TO, DOMESTIC INFLATION OF EXCHANGE RATE
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AND TERMS OF TRADE (TOT) CHANGES. CHAIR POSED PROBLEM IN TERMS OF HOW ECONOMY ADJUSTS TO LOSS OF REAL INCOME ENGENDERED BY TOT LOSS -- WHO ABSORBS? WP DID NOT ENGAGE IN EXTENSIVE ANALYTICAL DISCUSSION OF PAPER (PARTIALLY DUE ITS PRELIMINARY NATURE, PARTIALLY DUE ITS TARDY APPEARANCE) BUT MADE NUMEROUS SUGGESTIONS TO SECRETARIAT ON POSSIBLE IMPROVEMENTS. AUSTRALIAN DEL NOTED THAT NEED FOR REAL WAGE ADJUSTMENT NOT EXCLUSIVELY EXOGENOUS PHENOMENON, WHILE ITALIAN DEL ADDED OPPOSITE CONCEPT THAT TOT CHANGES MAY BE CAUSED BY DOMESTIC (INTERNAL) DEVELOPMENTS. SECRETARIAT (DOBELL) NOTED THAT WHEN THERE IS ASYMMETRICAL REACTION TO TOT CHANGES (I.E., INABILITY OF REAL WAGE TO ADJUST DOWNWARD), THEN OVER TIME REAL WAGE SUBJECT TO RATCHET EFFECT WHICH IS EQUIVALENT TO UPWARD MOVEMENT ON DEMAND CURVE FOR LABOR -- I.E., REDUCED, QUANTITY OF LABOR DEMANDED AFTER EACH TOT FALL).

4. FIXED EMPLOYMENT COSTS (CPE/WP4(78)1): SECRETARIAT ATTEMPTED TO DEMONSTRATE THAT LABOR BILL NOW RESPONDS LESS TO CYCLICAL INFLUENCES, MEANING THAT LABOR HAS TAKEN ON SOME ASPECTS OF "FIXED" COST. PAPER, HOWEVER, IS BASICALLY DEVOTED TO "NON-WAGE LABOR COSTS" (SOCIAL SECURITY, HEALTH BENEFITS, FRINGE BENEFITS, VACATIONS, ETC.) WHICH, AS U.S. DEL NOTED, ARE NOT "FIXED" COSTS IN STANDARD ECONOMIC TERMINOLOGY, ALTHOUGH THEY MAY BE "FIXED" PER EMPLOYEE. DISCUSSION REVEALED SUBSTANTIAL DIFFERENCE BETWEEN NORTH AMERICA AND EUROPE IN INFLUENCE OF NON-WAGE COSTS -- BOTH AS REGARDS PRIVATE FRINGE BENEFITS VS. GOVERNMENT PROGRAMS, AS WELL AS THE ROLE OF FRINGE BENEFITS IN DETERMINING THE COMPENSATION PACKAGE. TREND IN EUROPE TO ADOPT EMPLOYMENT GUARANTEES, LONG ADVANCE NOTICE FOR WORK FORCE REDUCTION AND LARGE REDUNDANT OFFICIAL USE

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DANCY PAYMENTS MENTIONED AS WORTHY OF FUTURE STUDY IN THIS AREA. SECRETARIAT HIGHLIGHTED DATA PROBLEMS IT HAD EXPERIENCED AND REQUESTED NATIONAL DELS' ASSISTANCE IN COLLECTING AND APPRAISING FURTHER DATA.

5. BACKGROUND PAPER ON MONETARY POLICY AND INFLATION (DES/NI(78)12): DESPITE INITIAL OBJECTIONS OF FRG (BUNDESBANK) DEL TO ANY DISCUSSION OF THIS PAPER, WP UNDERTOOK PRELIMINARY DISCUSSION DURING WHICH SUBSTANTIAL DIFFERENCES IN APPROACH TO MONETARY POLICY (AND TARGETRY) WERE EXPOSED WITH PARTICULAR REFERENCE TO IMPORTANCE OF THE "OPENNESS" OF THE ECONOMY IN DETERMINING MONETARY POLICY OBJECTIVES AND INSTRUMENTS. WP

REQUESTED EXPERTS' GROUP TO FOCUS ON IMPLICATIONS OF MONETARY TARGETRY FOR OVERALL MACRO POLICY, REQUESTING FURTHER ATTENTION THAN EVIDENT IN SECRETARIAT DOCUMENTATION TO RELATIONSHIP BETWEEN FISCAL AND MONETARY POLICY AS WELL AS EXTERNAL SECTOR, PARTICULARLY CAPITAL MOVEMENTS (INCLUDING ACCORDING TO SWISS DEL, "REQUIREMENT THAT CENTRAL BANK INTERVENE IN FOREIGN EXCHANGE MARKET WHEN EXCHANGE RATE DETERIORATES FROM PURCHASING POWER PARITY.") (SEE PARIS 21456 FOR REPORT ON SUBSEQUENT EXPERTS' GROUP MEETING.)

6. FUTURE WORK PROGRAM: WP AGREED THAT BULK OF ITS FALL MEETING WOULD BE DEVOTED TO DISCUSSION OF THE POLICY ASPECTS OF THE TOPICS COVERED AT THIS MEETING (PER PARAS. 2-5), BASED ON NEW SECRETARIAT PAPER EXTENDING AND CONSOLIDATING THESE ISSUES. THIS DISCUSSION WOULD INCLUDE AN ASSESSMENT OF THE ROLE OF PRICE AND INCOMES POLICIES WITHIN THE FRAMEWORK OF GENERAL DEMAND MANAGEMENT. THE WP ALSO AGREED TO SUGGESTION FROM CHAIR AND SECRETARIAT

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THAT IT UNDERTAKE PRELIMINARY DISCUSSION OF "BOTTLENECK" PROBLEM (CREATED BY INSUFFICIENT INVESTMENT, BOTH OVER-ALL AND SECTORAL) AS IT AFFECTS UNDERLYING INFLATIONARY TENDENCIES OF OECD ECONOMIES. U.S. DEL STRONGLY SUPPORTED COMPLETION OF WORK IN PROGRESS ON TOPICS COVERED IN PRELIMINARY FASHION AT JUNE MEETING, INCORPORATING INPUT FROM MONETARY EXPERTS MEETING AND JULY WASHINGTON CONFERENCE ON COLLECTIVE BARGAINING. INTERESTINGLY, FRG DEL ENCOURAGED SECRETARIAT TO PURSUE "BOTTLENECKS" TOPIC, CITING INSUFFICIENT INVESTMENT IN SOME SECTORS AS AN "IMPORTANT" PROBLEM AFFECTING CHANCES FOR SUSTAINED RECOVERY. (MISSION NOTE: THIS FRG STANCE SEEMS TO BE AT VARIANCE WITH FRG LINE IN INDUSTRY COMMITTEE REGARDING THE FUTURE INDUSTRIAL INVESTMENT REQUIREMENTS PROJECT.) U.S. DEL RECOGNIZED POTENTIAL ROLE FOR WP-4 IN LIMITED OFFICIAL USE

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"BOTTLENECKS" AREA, BUT REQUESTED SECRETARIAT TO ASSURE THAT ITS EFFORTS WERE FULLY COORDINATED WITH SIMILAR ACTIVITIES IN WP-2, INDUSTRY COMMITTEE, DAC, ETC. UK DEL ENDORSED THOROUGH REVIEW OF INCOMES POLICY, PARTICULARLY IN LIGHT OF PRELIMINARY FINDINGS OF PAPERS DISCUSSED AT JUNE MEETING.

7. WORKING PARTY FOUR SET ITS FALL MEETING FOR NOVEMBER 30/DECEMBER 1. SINCE WP WILL NOT MEET UNTIL AFTER NOVEMBER 16/17 MEETING, CHAIRMAN WILL PREPARE REPORT TO EPC, SUMMARIZING DISCUSSION OF JUNE WP-4 MEETING PLUS JULY 4-5 MONETARY EXPERTS GROUP AND JULY 10-13 WASHINGTON CONFERENCE ON COLLECTIVE BARGAINING. DRAFT REPORT WILL BE CIRCULATED TO WP IN OCTOBER FOR COMMENTS.

8. ACTION REQUESTED: IN PREPARING THE MATERIAL FOR THE NEXT MEETING OF THE WORKING PARTY, THE SECRETARIAT REQUESTS WRITTEN COMMENTS ON THE PAPERS DISCUSSED AT THE JUNE MEETING AS WELL AS FURTHER INFORMATION CONCERNING NON-WAGE LABOR COSTS, PARTICULARLY AS REGARDS SEPARATION AND REDUNDANCY PAYMENTS AND NOTICES OF LAY-OFFS. THE SECRETARIAT WOULD ALSO WELCOME ANY INFORMATION ON WORK CONCERNING MEASUREMENTS OF THE EFFICIENCY OF PRICE AND INCOMES POLICIES, EITHER IN THE FORM OF OFFICIAL REPORTS OR REFERENCES TO ANALYSES BY PRIVATE OR SEMI-PRIVATE INSTITUTIONS. THIS MATERIAL SHOULD BE AVAILABLE TO THE SECRETARIAT NO LATER THAN OCTOBER 15.

9. FOR EUR/RPE: PLEASE ASSURE THAT THIS CABLE IS DISTRIBUTED TO THE DEPARTMENTS OF LABOR AND COMMERCE GIVEN THE REFERENCES TO THE WASHINGTON CONFERENCE ON COLLECTIVE BARGAINING AND THE INDUSTRY COMMITTEE.
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